STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
FAIRCHILD INDUSTRIES, INC. [1]	:	
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Periods Ended December 31, 1988, August 17, 1989, June 30, 1990, and June 30, 1991.	:	DETERMINATION DTA NO. 815543

Petitioner, Fairchild Industries, Inc., c/o The Fairchild Corporation, 45025 Aviation Drive, Suite 400, Dulles, Virginia, 20166-7516, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the year ending December 31, 1988, the short period ending August 17, 1989, and the fiscal years ending June 30, 1990, and June 30, 1991.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on August 19, 1997 at 10:00 A.M., with all briefs to be submitted by March 24, 1998 which date began the six-month period for the issuance of this determination. Petitioner appeared by Roy H. Crosley, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Brian J. McCann, Esq. and James P. Connolly, Esq., of counsel).

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[1] The petition to the Division of Tax Appeals was filed as "Fairchild Holding Corp., as assumer of, and Shared Technologies Fairchild Inc., as successor to Fairchild Industries, Inc."

ISSUES

I. Whether the gains realized by petitioner on the sale of its Space & Defense Business should be included in its entire net income for purposes of determining its New York State franchise tax liability.

II. Whether the Division of Taxation ("Division") erred by refusing to reduce petitioner's entire net income and adjust the property factor to account for an abandonment loss.

III. Whether it was error for the Division to refuse to permit petitioner to utilize its Federal adjusted tax basis to determine its property factor.

IV. Whether the penalty imposed pursuant to Tax Law § 1085(k) should be abated.

FINDINGS OF FACT

In the course of this proceeding, the parties submitted a Stipulation of Facts and proposed findings of fact. Significant portions of these documents have been included herein.

Introduction

1. The years in issue are the calendar year ending December 31, 1988, the short period ending August 17, 1989, and the fiscal years ending June 30, 1990, and June 30, 1991.

2. Fairchild Industries, Inc. ("Fairchild") was incorporated in Maryland in November 1936. It maintained its corporate headquarters in Maryland through December 1984. From December 1984 through the years at issue, its corporate headquarters were located in Virginia. Fairchild became a Delaware corporation in May 1987.

3. Fairchild, including its consolidated subsidiaries, was a diversified manufacturer and service company.[2]

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[2] Fairchild's subsidiaries are not in issue in this matter.

4. As of January 1, 1987, Fairchild's business (not including subsidiaries) consisted of the following business segments: (a) the Space & Defense Electronics segment, which was engaged in the design, manufacture and sale of aerospace systems, subsystems and components primarily for the U.S. Government ("Space & Defense Business"); (b) the Industrial Products segment, which was involved in the design, production, and marketing of industrial controls and mechanical transmission devices for a variety of industries; and (c) the Aeronautics segment, which was engaged in the production of airplanes and airplane parts, principally through the Fairchild Republic Division ("Fairchild Republic") headquartered in Farmingdale, New York.

5. From 1975 through the years indicated below, Fairchild was a New York taxpayer which filed a General Business Corporation Franchise Tax Return, Form CT-3, with New York State that included, among other things, the following: (a) the Space & Defense Business, as defined hereafter, through the year ended June 30, 1990; (b) the Fairchild Republic Company, a division of Fairchild ("Fairchild Republic") through the year ended December 31, 1987; and (c) the activities of the former Fairchild Republic from January 1, 1988 through June 30, 1991.

6. Fairchild Republic and the Space & Defense Business operated as separate divisions and produced different products for distinct businesses. From at least 1978 through the years in issue, Fairchild's only division or operation located in the State of New York was Fairchild Republic.

Fairchild Republic

7. Historically, Fairchild was a corporation specializing in aircraft development and manufacturing, which, over time, expanded into other businesses including communications and spacecraft. Fairchild's Annual Report states:

> For most of its corporate existence, Fairchild Industries and its predecessor companies have been primarily engaged in the aircraft development and manufacturing business. During the 1960's, that technological background led the company into greater participation in spacecraft development and manufacturing. With the decline in the NASA budget and the perennial uncertainty concerning the Defense Department's commitment to the new hardware programs, Fairchild Industries has recently sought to broaden its business base into new areas capable of utilizing its basic technological expertise, as well as into unrelated industries with good long term growth and with profit margins higher than those usually obtained in the aerospace industry.
>
> These considerations have sparked Fairchild's move into various aspects of the communications business . . . In addition, Fairchild has begun a major real estate development . . . . (Fairchild Industries, Inc./1972 Annual Report, p.12.)

8. As of January 1, 1987, Fairchild's largest business segment (in terms of employment) was Fairchild Republic. Since 1976, Fairchild Republic was much larger than the Space & Defense segment, in terms of employment, as Fairchild Republic had 5,500 employees while the Space & Defense segment had 500 or 600.

9. From at least 1970, until it ceased functioning as a separate division, Fairchild Republic was headquartered in Farmingdale, New York, where it also maintained airplane production facilities since at least 1970. At one time, Fairchild Republic also had production facilities in Maryland.

10. Fairchild Republic was Fairchild's only presence in New York during the years in issue.

11. Fairchild entered into the airplane production business in New York in 1965, when it acquired Republic Aviation Corporation. At Farmingdale, Fairchild Republic produced the F-105, which saw action during the Vietnam War.

12. In 1965 Fairchild signed a lease with Grumman Corporation ("Grumman") which permitted Grumman to use land on the premises of Fairchild Republic for a period of 50 years at a fixed price. Grumman used the land to construct a building which was used as a wind tunnel.

13. In 1973 and 1974, Fairchild Republic secured Department of Defense contracts to develop the A-10 close support aircraft and, thereafter, to produce the airplane. The A-10, known as the "Warthog ," was used in the Persian Golf War.

14. Throughout the remainder of the 1970s and the early 1980s, the Farmingdale facility was involved in the production of the A-10 aircraft. In total, Fairchild Republic delivered 713 A-10s and, as of 1981, Fairchild received 2.9 billion dollars pursuant to the A-10 contracts.

15. From at least 1975 through at least 1979, the sales of A-10 aircraft constituted a significant portion of Fairchild's sales. The following chart shows sales of the A-10 as a percentage of petitioner's total sales (all sales amounts are in thousands).

Year	1979	1978	1977	1976	1975
Sales of A-10 units and parts	$425,824	$325,507	$215,338	$95,961	$49,335
Fairchild Industries Inc.'s Total Net Sales	$717,859	$543,796	$399,341	$263,610	$218,538
Sales of A-10 as a Percentage of Total Net Sales	59.3%	59.9%	53.9%	36.4%	22.6%

16. During the period of time reflected by the foregoing chart, Fairchild's management continued to invest in research and development in order to diversify the corporation's operations and maintain the company's technological edge. In this vein, petitioner's 1978 Annual Report states:

> Fairchild management has sought to achieve a balance among technological innovation, service to the defense and NASA establishments, domestic satellite communications and commercial/industrial product fields. Among the steps taken over the past few years leading to the Company's present position have been substantial investments in plant renovation, equipment, and personnel training in all business areas. Moreover, Fairchild has concentrated on product and service development and improvement programs, as well as expanded research and development activities. (Fairchild Industries Annual Report 1978, p. 4.)

17. Fairchild Republic obtained a contract for the development of an Air Force trainer warplane, known as the T-46, in 1982. However, once the last A-10 was delivered in 1984, Fairchild Republic began to lose its position as petitioner's dominant business segment. Petitioner's 1984 Annual Report notes "a marked shift in the relative roles of the Company's major business group, " as the "Government Aerospace" segment lost its "once dominant position" due to the ending of the A-10 prime contract.

18. Fairchild Republic sustained losses of approximately $375,000,000.00 on its two main programs, the SF-340 and the T-46 from 1984 through 1986.

19. Official notice is taken that Federal budget outlays for national defense for the Federal fiscal year 1989 increased 4½% over the national defense budget outlays for the prior fiscal year but decreased 1.4% in the succeeding Federal fiscal year. Such outlays continued to decline through at least Federal fiscal year 1994. The 1989 Federal fiscal year budget outlays for national defense were 93% greater than such outlays for Federal fiscal year 1981. According to the Office of Management and Budget, the Federal budget outlay for National defense was approximately $290,361,000,000 for 1988, approximately $303,559,000,000 for 1989 and approximately $299,331,000,000 for 1990.

20. After the Air Force decided to discontinue the T-46 program, Fairchild announced on March 13, 1987 the closure of Fairchild Republic in Farmingdale, New York to be completed no

later than December 31, 1987. For financial reporting purposes to Fairchild Industries' shareholders, depreciation stopped accruing on the machinery, equipment and buildings in Farmingdale, New York on December 31, 1987 because thereafter these items were not used for any purpose.

Space & Defense Business

21. Petitioner's Space & Defense Business has been in existence since at least 1969.

22. During the audit period, three companies, which were not incorporated, comprised the Space & Defense Business: (a) Fairchild Space Company, which produced satellites, satellite and spacecraft subsystems and provided technical support for the National Aeronautics and Space Administration ("NASA"); (b) Fairchild Communications & Electronics Company, which manufactured airborne electronics ("avionics") for military aircraft and ground systems for the U.S. Government command, control, communications and intelligence market; and, (c) Fairchild Control Systems Company, which designed and manufactured fluid controls, environmental controls and aerospace subsystems for spacecraft and aircraft applications.

23. The Space & Defense Business participated on many NASA and Department of Defense contracts. The 1987 Annual Report of Fairchild Industries, Inc. states "[e]very major space and missile program from Gemini and Minuteman through the Space Shuttle and MX has relied on the [Fairchild Control System] company's fluid control hardware for its compactness, durability, light weight, and reliability." (Fairchild Industries 1987 Annual Report, p.6.)

24. For its part, the Fairchild Space Company worked closely with NASA in order to advance its role as a prime contractor and to further its position in the area of reusable spacecraft that can be repaired and sustained in orbit. This was pursued through a program to build a space

Explorer Platform and a satellite for the "Ocean Topography Experiment." The 1978 Annual Report mentions the Space & Defense Business's involvement as a prime contractor for two components of "the Multimission Modular Spacecraft (MMS) for NASA's Goddard Space Flight Center" (Fairchild Industries Annual Report 1978, p. 8.). The Annual Report describes MMS as "intended to be the standard spacecraft 'bus' for many future NASA missions using the Space Shuttle" (***id***). In the 1981 Annual Report, MMS is defined as a "retrievable and in-orbit refurbishable satellite" (Fairchild Industries Annual Report 1981, p. 6).

25. The 1979 Annual Report highlights Fairchild Space & Electronics Company as a prime contractor "for the integration of NASA's Multimission Modular Spacecraft (MMS)" (Fairchild Industries Annual Report 1979, p. 8) and notes that, as a result, "FSEC is well-positioned to participate in various mission applications during the space shuttle era." ***(Id.***)

26. Fairchild Space Company's close work with NASA on the MMS bore fruit in 1986. That year's Annual Report notes that "higher than normal investment in bidding programs . . . paid off as the division won important new projects that could have significant positive impact on the future." (Fairchild Industries 1986 Annual Report, p. 6.) Among the new projects mentioned by the 1986 Annual Report was Fairchild Space Company's "selection by [NASA]'s Goddard Space Flight Center to build an Explorer Platform that will support the Extreme Ultraviolet Explorer experiment." (***Id*** at p. 4.)

27. Petitioner's 1987 10-K shows that the company saw the winning of the Explorer Platform contract as related to efforts the company had been making for years, including through the MMS program:

> The Company, through one of its divisions, Fairchild Space Company, produces satellites, satellite systems, spacecraft systems and electronic and mechanical

> hardware and provides technical support for the National Aeronautics and Space Administration "NASA" and the Department of Defense spacecraft markets. The Company is involved in supplying multimission modular spacecraft ("MMS"), a platform designed to be a standard spacecraft, for use in scientific satellite programs with the capability to allow for on-orbit service and repair. MMS has been used on eight satellites and the Company has been involved in a repair mission on one of the satellites. In 1987, the Company was awarded the Explorer Platform contract by NASA which is the first space platform designed for payload change-out on-orbit and will also have the capacity for on-orbit repair and maintenance. (1987 10-K, p. 202.)

28. Apart from being chosen to build the Explorer Platform, in 1986 Fairchild through Fairchild Space Company ("FSC"), was also selected by NASA's Jet Propulsion Laboratory to negotiate a contract "to build a satellite for the Ocean Topography Experiment" ("Topex") which was to be used to measure sea level and ocean currents (Fairchild Industries 1986 Annual Report, p. 4).

29. Petitioner's Annual Reports show that petitioner's campaign that culminated in its selection to build the Topex satellite commenced as early as 1984, during which year FSC completed "a study . . . for the design of a new Topex satellite." (Fairchild Industries 1984 Annual Report, p. 5).

30. According to Fairchild Industries' 1986 Annual Report, the Topex and Explorer Platform contracts were "vigorously pursued to enable Fairchild Space Company to *return* to the role of a prime contractor and advance its position in the realm of reusable spacecraft that can be maintained and repaired in orbit." (Fairchild Industries 1986 Annual Report, p. 4 [emphasis added].)

31. In addition to the Topex and Explorer Platform contracts, another source of the success of the Space & Defense Business in 1987 was the "Data Transfer System" produced by the Fairchild Communications & Electronics Company, which had a $220 million "backlog and

follow-on business." (Fairchild Industries 1987 Annual Report, p. 8.) The Data Transfer System which "consists of a memory cartridge and cockpit processor that preprogram(s) the mission planning information, including weapons and navigation information, program the all-digital cockpit with that data, and record mission data and systems performance for post-flight analysis," was developed for the U.S. Air Force F-16 aircraft in 1981 (***id***).

32. As a result of, among other things, winning the Explorer Platform and Topex contracts and the continuing success of the Data Transfer System, Fairchild was able to greatly increase the Space & Defense Business's sales and operating income during the period from 1984 through 1988 as follows:

Tax Year Ending	Sales (in 000's)	Operating Income (in 000's)
December 31, 1988	$200,787	$16,675
December 31, 1987	122,214	5,147
December 31, 1986	142,726	4,972
December 31, 1985	137,632	6,475
December 31, 1984	136,941	14,035

33. At the end of 1986, the Space & Defense Business had a backlog in the amount of $149,613,000.00 and by the end of 1987 the backlog grew to $280,368,000.00. By the end of 1988, the backlog and follow-up business was about $300,000,000.00.

34. Neither Fairchild Control Systems Company, Fairchild Space Company nor Fairchild Communications and Electronics Company had any allocation to New York during the years in issue related to property or payroll.

35. The Federal government examines the historical performance of the applicant when it reviews an applicant's response to a request for proposals ("RFP").

Operation of Fairchild's Unitary Business

36. During the period 1975 through the years at issue, Fairchild, including its operation in New York, was a unitary business enterprise.

A. ***Centralized Management***

37. The general manager of the Space & Defense Business, until its sale, and the general manager of Fairchild Republic, until March 1990, reported to a corporate officer of Fairchild who was assigned to the headquarters of Fairchild.

38. Fairchild conducted general managers' meetings at its corporate headquarters on a monthly basis at which the general managers of each of the divisions (including Fairchild Republic) would present their monthly operating report.

39. From at least 1975 until they were no longer a part of petitioners' unitary business, Fairchild Republic and the Space & Defense Business prepared their own annual budgets and strategic business plans and submitted the same to Fairchild's corporate headquarters for approval.

40. Fairchild's Procedures Manual contained the following policies:

(A) All significant issues and decisions facing the corporation are reviewed by the Managing Council, appointed by its Chairman and Chief Executive Officer. Significant issues and decisions included submissions of only those contract bids for contracts that: (a) exceeded 10% of that division's current year's forecasted sales volume; (b) had a face value of $5,000,000.00 or more; (c) had unusual technical risks; (d) had unusual contract obligations for penalties or warranties; and (e) had fixed-price provisions for development-type performance. (Policy No. 1-2.)

(B) Requires "the advance written approval of the Chief Executive Officer and the President for the appointment of divisional officers of the corporation and the Chief Executive Officer, the President and the Corporate Controller for the granting of divisional contract signatory authority." (Policy No. 1-3.)

(C) The Division or Subsidiary Chief Financial Officer is required to submit contract proposals containing certain types of clauses "to the Corporate Controller, or his designee, for review and approval prior to submission to prospective customers." (Policy Memo 3-13.)

(D) Establishment of "an effective method of transferring employees between divisions." (Policy Memo 18.)

(E) "When the Corporation utilizes the advertisement media as a means of communicating with desired publics, a unity of appearance and message content will be maintained so distinctive, easily recognizable impressions are projected . . . The Corporate Public Relations Department has ultimate responsibility for the advertising programs of the Corporation and subsidiaries." (Policy No. 65.)

B. ***Centralized Services***

41. Fairchild's headquarters allocated a portion of the expense of providing the following services to each of its operating divisions: (a) electronic data processing; (b) legal services; (c) accounting; (d) payroll; (e) tax return preparation; and (f) human resources management.

42. For the period 1975 through the years in issue, or in the case of the Space & Defense Business, through the date of its sale, Fairchild maintained one or more of each of the following

types of employee benefit plans, in which employees of the Fairchild Republic and the Space & Defense Business, as well as other divisions of the corporation, participated: (a) defined benefit plans; (b) defined contribution plans; and, (c) employee stock ownership plans.

43. For the period 1975 through the years in issue, or, in the case of Fairchild Republic, through March 1990, and, in the case of the Space & Defense Business, through the date of its sale, Fairchild maintained one or more stock option plans and nonqualified deferred compensation plans, in which certain key employees of Fairchild Republic and the Space & Defense Business, as well as other divisions of the corporation, participated.

44. For the period 1975 through the years set forth below, Fairchild obtained loans which were used in whole or in part to fund operations or projects of: (a) Fairchild Republic through the year ended December 31, 1987; and (b) the Space & Defense Business through the year ended June 30, 1990.

45. For the period 1975 through the years in issue or, in the case of the Space & Defense Business, through the date of its sale, Fairchild maintained one or more insurance policies which provided coverage to the operators or property of Fairchild Republic and the Space & Defense Business as well as the other divisions of the corporation.

46. Fairchild's headquarters also oversaw the financial activity and the running of all contracts, including government contracts, of the divisions.

C. Intra-corporate transactions

47. During the period 1975 until the discontinuance of manufacturing at Fairchild Republic's Farmingdale facility in 1987, there took place: (a) transfers of services provided by or products manufactured or acquired by Fairchild Republic to other divisions of Fairchild, and (b)

transfers of services provided by or products manufactured or acquired by other divisions of Fairchild to Fairchild Republic.

48. According to the table below, which was obtained from petitioner's 1985 Annual Report at page 13, the level of intra-corporate transactions by the Communications, Electronics & Space segment (whose makeup overlaps somewhat with that of the Space & Defense Business) varied during the period from 1981 through 1985 as follows (amounts are in thousands):

	1985	1984	1983	1982	1981
Intersegment sales included in Communications, Electronics & Space	$3,319	$3,914	$3,332	$6,670	$12,318

49. Proprietary information developed at Fairchild Republic may have been shared with the Space & Defense Business.

Closing of the Fairchild Republic Facility

50. During the first quarter of 1987, the Board of Directors of Fairchild authorized the closing of Fairchild Republic's plant in Farmingdale, New York.

51. The plant shutdown required Fairchild to implement a closure plan for Farmingdale as mandated by Federal and New York State law, which plan was certified as complete in 1988.

52. Petitioner began the process of winding up production at the Farmingdale facility in April 1987, and production ceased by December 1987. As part of the closure plan, petitioner took steps to eliminate environmental hazards at the site, including cleaning and removing all underground or below-ground storage tanks, except those required for heating fuel.

53. In July 1987, Mr. Gawronski, who was vice president, contracts and legal, was made the general manager of the Fairchild Republic Division responsible for completion of existing contracts, disposal of the assets of the Farmingdale operations and completion of all actions necessary for the closedown of the facility in Farmingdale and making it available for sale under a contract signed in October 1987.

54. There were 3000 employees at Fairchild Republic on March 13, 1987. The reports of the General Manager's meetings and internal memoranda thereafter indicated the following number of employees: 349 employees on December 31, 1987; 163 in April 1988; 124 in May 1988; 35 in July 1988; 23 in November 1988; 19 in December 1988; 11 in August 1989, and 1 in March 1990.

55. In 1987, Fairchild Republic formed a unit known as the Long Island Engineering Center in Farmingdale, New York ("LIEC") to which a group of its engineers was assigned to work on various contracts to support the A-10 aircraft which had been manufactured by Fairchild Republic from 1973 to 1984.

56. In October of 1987, Fairchild Republic sold the LIEC to Grumman Aerospace Corporation.

57. In October 1987, Fairchild signed a contract, subject to several contingencies, to sell 88 of the approximately 100 acres that comprised Fairchild Republic's real property in Farmingdale, New York, to Retail Stores Credit Corp. for $41,000,000.00. The 88 acres in the contract of sale were on the east side of Route 110 and included 1.8 million square feet of buildings previously used to manufacture aircraft. Twelve acres on the west side of Route 110 were not included in the contract of sale because the purchaser was not interested in this property

which had been classified as environmentally sensitive by the New York State Department of Environmental Conservation ("DEC").

58. The contract required Fairchild Republic to evacuate each building as production ceased, to remove the material and equipment in each building, and to secure each building after the removal of all material and equipment in a manner satisfactory to the buyer. The tenth section of the contract concerned the environment and provided, in part, that if an adverse condition was found to exist prior to closing the seller would perform "Remediation Work" to the satisfaction of the DEC. If the estimated cost exceeded $4,100,000.00 and the estimated completion date were after November 30, 1989, the contract accorded the purchaser certain rights. Furthermore, the contract required the curing of any violations of land use laws or ordinances created in these same buildings as a result of petitioner's removal of property. Section 21(B) of the contract acknowledged that the seller would remove some tanks and equipment and that the seller intended to sell various fixtures, equipment and personal property. Pursuant to this section, the seller was under no obligation to fill holes or otherwise restore or repair the premises; however, the seller agreed to "restore" any damage to five particular buildings as a result of its closure plan. The contract also provided that, subject to a monetary limit, the seller was expected to cure any violations of law that affected the same buildings as mentioned in paragraph 21(B). Additionally, petitioner was required under the contract to maintain insurance on these structures through the date of closing.

59. In October 1987, Fairchild Republic sold the composite bonding center in Hagerstown, Maryland.

60. By July 15, 1988, all of the Fairchild Republic buildings at Farmingdale, New York, had been officially closed, and the remaining office personnel, consisting of 35 employees were relocated to a smaller rental office building. None of the employees at Fairchild Republic was transferred to any other division of Fairchild as a result of the Fairchild Republic shutdown. The remaining 35 employees were involved in a variety of tasks including: resolving matters with government auditors; collecting and archiving records; performing exit interviews and pension distribution procedures; overseeing security; and resolving open environmental issues. The Fairchild Republic facility was vacated in June 1988.

61. On August 17, 1989, Fairchild and wholly-owned subsidiaries formed a partnership, Fairchild Associated Partners, renamed Fairchild Communications Services Company ("FCSC"), in which Fairchild retained a 49.27% partnership interest.

62. All the partners of FCSC were wholly-owned subsidiaries of Fairchild during the years in issue.

63. Fairchild was the managing partner of FCSC during the period August 1989 to November 1989.

64. Fairchild received a letter from the DEC dated August 2, 1989, notifying Fairchild of the delisting and segmentation of the Fairchild Republic property and that a specified portion of the property would be listed as classification two as mandated by section 27-1305 of the Environmental Conservation Laws.

65. In November 1989, Retail Stores Credit Corp., the purchaser of the Farmingdale real estate, terminated its contract to purchase the entire 88 acres because of Fairchild's inability to obtain necessary environmental clearance. Fairchild then negotiated a termination of the lease

with Grumman.

66. On November 17, 1989, Fairchild assigned all but a 0.27% interest in FCSC to a wholly-owned subsidiary.

67. The assessed value for the real estate tax on the vacant unused 100 acres in Farmingdale, New York was reduced in 1989 pursuant to an order signed by the Honorable Arthur M. Cromarty of the Supreme Court, State of New York, County of Suffolk. After applying the appropriate equalization factors to these assessed values, the fair market values of the vacant unused 100 acres in Farmingdale, New York, were as follows:

Tax Year	Value
1989-1990	$21,429,000.00
1990-1991	17,260,000.00
1991-1992	14,671,000.00

68. The machinery and equipment at the Farmingdale facility were sold in 1987 through 1989.

The Sale and Restructuring of Fairchild

69. On May 11, 1989, Banner Industries, Inc. made a public tender offer for all of the outstanding stock of Fairchild at $18.00 per share through an indirect, wholly-owned subsidiary pursuant to an Agreement and Plan of Merger ("Merger").

70. On May 31, 1989, Banner Industries, Inc. ("Banner") and its subsidiary entered into an Asset Purchase Agreement with Matra, S.A., ("Matra") a French corporation, and a U.S. wholly-owned subsidiary of Matra, pursuant to which, subject to the consummation of the Merger, Matra's subsidiary agreed to purchase from Fairchild the assets of Fairchild's Space & Defense Business for $245,000,000.00 plus interest.

71. Matra was interested only in acquiring the Space & Defense Business because it was familiar with this type of business. It was also interested in acquiring a base from which it could enter the United States market. In this regard, Matra felt that it had a superior technology which it could bring to the United States market. Matra also took into account the fact that the Space & Defense Business had substantially more sales and profits in 1988 than in 1987.

72. On August 18, 1989, Banner's subsidiary was merged with and into Fairchild, thereby increasing Banner's ownership of Fairchild to greater than the amount necessary to end Fairchild's taxable year for Federal income tax and New York franchise tax purposes.

73. In 1990, after its acquisition of Fairchild Industries, Inc., Banner changed its name to the Fairchild Corporation. One of the reasons for the change in names was the perception that the name Fairchild was valuable.

74. As a result of Banner's acquisition of control of Fairchild, Fairchild's unused New York investment tax credits were lost due to a change in New York law effective in April of 1989 which disallowed credits upon a change of control or ownership.

Sale of the Space & Defense Business

75. On August 25, 1989, Fairchild sold its Space & Defense Business to Matra's subsidiary, Matra Aerospace Inc., resulting in a taxable gain of $209,335,730.00. Fairchild's Board of Directors approved the sale.

76. As part of the sale to Matra, Matra retained the right to use the "Fairchild" name and eventually created the Fairchild Space and Defense Corp.

77. Following Matra's acquisition of the Space & Defense Business, the vice chairman

and deputy chief executive of the new business segment stated that “we will retain the entire management and workforce in the Germantown, Maryland and Los Angeles operations.”

78. The record does not show what assets were included in the sale.

79. The Space & Defense Business, excluding Maryland and California real estate, was sold by Matra in 1994 for approximately $82,000,000 in cash and stock.

Valuations

80. The Carlyle Group, L.P. (“Carlyle”) prepared a study, dated October 1988, in conjunction with petitioner’s effort to obtain “equity commitments” from investors interested in investing in a partnership formed for the purpose of acquiring 100% of Fairchild’s common stock. In discussing the prospects of the Space & Defense Business, the study mentioned Fairchild Space Company’s winning of the Topex and Explorer Platform contracts, its backlog of sales, and the expected increase in its sales in 1988. The study also noted that the fluid and control hardware developed by the Space & Defense Business was utilized by every major space and missile program. The Carlyle study included estimates of the value of each of Fairchild’s business segments from itself, Drexel, Burnham, Lambert and Balis, Zorn, Gerard, Inc. The estimates of the value of the Space & Defense Business were as follows: Carlyle - $160,000,000.00, Drexel, Burnham, Lambert - $220,000,000.00; and, Balis, Zorn, Gerard, Inc. - $210,000,000.00.

81. Carlyle also prepared a “Due Diligence” study, dated May 1989, entitled “Acquisition of Fairchild Industries, Inc. by FII Transaction Partners, L.P.” (“1989 Carlyle study”). On a page entitled “Investment Considerations” the study noted that Fairchild “has skilled managers in place at the operating level.”(Acquisition of Fairchild Industries, Inc. by FII Transaction

Partners, L.P., p. C00574). The study also included a page entitled "Acquisition of Fairchild Industries Strategic Plan Overview" which noted as one of its points under the caption "Build an Aerospace/Defense Company" the following: "Capitalize on the Company's historic strengths and the value of the Fairchild 'franchise'"(***id***., at p. C00580).

Fairchild's Filing History

82. For each of the taxable years from 1979 through the year ended December 31, 1987, Fairchild's franchise tax, as finally agreed by Fairchild and the Division, was the minimum tax of $250.00 per taxable year.

83. The business allocation percentage ("BAP") reported on petitioner's Forms CT-3 during the years 1975-1986 was above 25% for all years except one year. The business allocation percentages reported by Fairchild during the years in issue were 9.1357%, .5716%, and 11.61%, respectively.

84. On the Fairchild Industries, Inc. General Business Corporation Franchise Tax Return for the year ending December 31, 1987, an "X" was placed in the "No" box in response to the question "Are you making the election to use fair market value in the property factor?". On each of the general business corporation franchise tax returns for the year ending December 31, 1988 and the period ending August 17, 1989, an "X" was placed in the yes box in response to the question "Did you make an election last year to use fair market value in the property factor?". On the return for the calendar year ending December 31, 1988, petitioner gave a negative response to the question of whether it was the first year that petitioner was making the election to use fair market value in its property factor. It did not provide a response to this last question on the return for the period ending June 30, 1990. Similarly, on the return for the period ending

June 30, 1991, petitioner did not respond to the question of whether this was the first year it was making the election to use fair market value in its property factor. Petitioner gave an affirmative response to the question "Did you make an election to use fair market value in your property factor?" on its General Business Corporation Franchise Tax Return for the period ended June 30, 1990. In each of the foregoing returns, the figures used by petitioner to calculate the property factor were based on net book value as a measure of fair market value.

85. In its CT-3 for the fiscal years ended December 31, 1988 and August 17, 1989, Fairchild included the figures attributable to the Space & Defense Business in the computation of entire net income and the figures set forth under the "Everywhere" column of Schedule B, Part 1 (Computation of Business Allocation Percentages).

86. The gain from the sale of Fairchild's Space & Defense Business was reported on Form CT-3 for the taxable year ended June 30, 1990, as follows:

Form D (Form 1120), Part II	$176,580,756.00
Form 4797, Part II	28,062,444.00
Other Income	4,692,530.00
	$209,335,730.00

The portion of the sale price allocated to the real estate was approximately $27.4 million.

87. For purposes of its Federal tax obligations, Fairchild Industries determined that it sustained a taxable loss of $14,248,174.00 in the tax year ended June 30, 1990.

88. In calculating the $209 million gain from the sale of the Space & Defense Business, Banner subtracted the tax basis of the Space & Defense Business's property ($70,733,207.00) from the total consideration received from Matra ($208,069,000.00).

89. Petitioner reported $176,580,756.00 of the gain as a long term capital gain on its U.S. Corporation Income Tax Return for the fiscal year ended June 30, 1990. The tax return distributed the long term capital gain portion of the gain as follows:

Type of Asset	Gross Sales Price	Cost or Other Basis Plus Expense of Sale	Gain (or Loss)
Contract Backlog	$30,908,000	$0	$30,908,000
Proprietary Technology	32,100,000	0	32,100,000
Software/Data Base	1,200,000	0	1,200,000
Research & Development	2,400,000	0	2,400,000
Assembled Workforce	14,632,000	0	14,632,000
Goodwill	68,507,000	0	68,507,000

90. On its General Business Corporation Franchise Tax Return for the tax year ended June 30, 1990, petitioner excluded the gain from the sale of the Space & Defense Business from its entire net income. The report contained the following statement explaining the exclusion:

> THE SUBTRACTION FROM INCOME LISTED ON LINE 16 IS FOR THE GAIN FROM THE SALE OF NON-UNITARY ASSETS PERSUANT [sic] OF [sic] THE FINDING IN BONNER PROPERTIES, INC. VS. NEW YORK STATE, MAY 15, 1984.

On the same form, Fairchild reported that no receipts were allocable to New York. Following its audit, the Division made no adjustment to that receipts factor.

Abandonment Loss

91. The Federal income tax return of Fairchild Industries, Inc. and its related subsidiaries for the fiscal year ended June 30, 1992 included an abandonment loss of the Federal adjusted tax basis of certain buildings at the Fairchild Republic site. The buildings that were treated as

abandoned in the 1992 Federal return ceased being used in 1988 as a result of the shutdown announced in 1987 and the signing of the contract in October 1987.

92. Fairchild did not claim an abandonment loss on its Federal or New York return for the year 1988.

Audit History

93. The major issue on audit was whether Fairchild properly excluded from its entire net income the gain from the sale of the Space & Defense Business segment in its return for the year ending June 30, 1990. The Division determined that the gain from the sale of the Space & Defense Business should be included in petitioner's entire net income. Moreover, the BAP of 4.7351%, which was calculated by the Division during the audit, caused $9,912,256.00 of Fairchild's gain from the sale of the Space & Defense Business to be included in petitioner's allocated taxable net income.

94. The Division issued a Notice of Deficiency, dated October 31, 1994, stating that tax was due in the amount of $1,329,257.00 plus interest in the amount of $597,927.82 and penalty in the amount of $132,297.00 for a balance due of $2,059,481.82.[3] In a Conciliation Order dated September 13, 1996, the Bureau of Conciliation and Mediation Services modified the Notice of Deficiency by reducing the amount of tax sought to $1,052,219.00. The Conciliation Order further directed that the amount of the penalty be reduced to $105,348.00 and interest be computed at the applicable rate.

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[3] The Division asserted a penalty for substantial underpayment of tax pursuant to Tax Law § 1085(k) for the year ended December 31, 1988 and the period ended June 30, 1990.

95. The request filed by petitioners with the Bureau of Conciliation and Mediation Services ("BCMS") included an argument that petitioner was entitled to claim an abandonment loss on its return for the year 1988. The abandonment loss claim was based on the following:

Federal adjusted tax basis	$7,118,435.00
Less basis in buildings not abandoned:	
Building 21 (Guardhouse)	(77,980.00)
Building 64 (Archive Storage)	(129,757.00)
Total abandonment loss	$6,910,698.00

The abandonment loss claim was not resolved at BCMS because the Division concluded that there was no provision in the Tax Law for an abandonment loss.

96. In accordance with State Administrative Procedure Act § 307(1), petitioner's proposed findings of fact have generally been accepted and incorporated herein. However, it is noted that petitioner's proposed finding of fact 8 was modified to reflect the record.

The Division's proposed findings of fact have also been generally accepted and incorporated herein. However, the following proposed findings of fact were changed to reflect the stipulation: 5, 6, 39, 43, 44, and 80. The following proposed findings of fact were either modified to reflect the record or rejected in whole or in part because the proposed finding of fact was not supported by the record at the location indicated in the proposed finding of fact: 6, 8, 10, 14, 15, 21, 22, 30, 32, 37, 38, 45, 47, 69, 79, 80 and 81. The following proposed findings of fact were rejected in whole or in part because they were argumentative or speculative: 19, 44, 45, 70, 71, 72, 87, 88 and 89. The following proposed findings of fact were expanded to further reflect the record: 22, 29, 31, 44 and 74.

Additional findings of fact were also made.

CONCLUSIONS OF LAW

A. The first issue presented is whether petitioner has established that the inclusion of the gain on the sale of the Space & Defense Business resulted in the taxation of extraterritorial values and, if so, whether the Division's failure to exercise its discretion under Tax Law § 210(8) to revise the business allocation percentage was erroneous.

B. Every corporation subject to Article 9-A franchise tax must allocate its business income within and without New York using a three-factor formula taking into account its property, receipts and payroll (Tax Law § 210[3]; 20 NYCRR 4-2.2). The formula is intended to reflect a taxpayer's activities within New York (***Matter of Allied-Signal Inc. v. Tax Appeals Tribunal***, 229 AD2d 759, 645 NYS2d 895, 898, ***appeal dismissed***, 89 NY2d 859, 653 NYS2d 281). Tax Law § 210(8) grants the Commissioner of Taxation the discretion to vary the statutory formula if it does not properly reflect the activity, business, income or capital of the taxpayer in New York.

The Court of Appeals has outlined the Constitutional considerations as follows:

> The Due Process and Commerce Clauses of the United States Constitution prevent a State from taxing income of a nondomiciliary corporation arising out of extraterritorial activities unless there is a 'minimal connection' or 'nexus' between the outside activities and the taxing State, and a 'rational relationship between the income attributed to the State and the intrastate values of the enterprise.' Under a long and unbroken line of Supreme Court precedent, if the nondomiciliary corporation engages in business in the taxing State . . . , the taxing State need not identify and select out its specific intrastate income-producing activities so long as the corporation is operating a unitary business enterprise and the income is derived from the unitary business; it may then apply an apportionment formula to tax an appropriate proportional share of the interstate income of the enterprise. (***Matter of British Land (Maryland) Inc. v. Tax Appeals Tribunal***, 85 NY2d 139, 623 NYS2d 772, 775 [citations omitted].)

The foregoing principles are limited by the proposition that a State's apportionment formula may not tax income "which cannot in fairness be attributed to the taxpayer's activities within the State" (***Matter of British Land (Maryland) Inc. v. Tax Appeals Tribunal***, 85 NY2d 139, 623 NYS2d 772, 775, quoting, ***Allied-Signal, Inc. v. Director, Div. of Taxation***, 504 US 768, 780, 119 L Ed 2d 533).

C. Relying upon ***British Land***, petitioner's first substantiative argument is that the gain from the sale of the Space & Defense Business is grossly disproportionate to Fairchild's activities in New York. Initially, petitioner acknowledges that Fairchild was a unitary business in New York during the years in issue. However, it is contended that the imposition of the tax is unconstitutional because the tax burden is "out of all appropriate proportion to Fairchild's business in New York." (Petitioner brief, p.21.) Petitioner submits that the foregoing proposition is demonstrated by the fact that the gain on the sale of the Space & Defense Business was grossly disproportionate to Fairchild's only activity in New York which was the shutdown of its former Fairchild Republic facility. It is then noted that Fairchild's business receipts factor for the fiscal year ended June 30, 1990 was zero and that, on a separate accounting basis, Fairchild had losses in excess of $14 million for its activity in New York. It is submitted that there is obviously a gross disproportionality between no gross receipts in New York and the attribution of nearly $10 million in gain from the sale of the Space & Defense Business.

Petitioner lists a series of factors for the proposition that the gain from the sale of the Space & Defense Business was attributable to factors outside of the State of New York and occurred after the activities of Fairchild Republic, which was the only New York operation, ceased. First, Matra S.A. was interested only in the Space & Defense Business which had no operations in New York. Second, Matra S.A.'s interest in the Space & Defense Business was allegedly spurred by the substantial increase in the Space & Defense Business's gross sales and operating income in the year preceding the sale. In this regard, petitioner notes that sales increased 64 percent from 1987 to 1988 and operating income increased 324 percent during the same period. The third principal factor was that Matra S.A. was looking for a business that would provide it with access to the United States market and the Space & Defense Business was viewed as a means for entering that market. Fourth, it appeared that the Space & Defense Business had a bright future as a result of contracts that were entered into in 1987 by the Fairchild Space Company which was part of the Space & Defense Business. The contracts were to design the Explorer Platform and to build the Ocean Topography Experiment. In addition, the business backlog for the Space & Defense Business increased from $200 million in 1987 to $300 million in 1988. Petitioner submits that the business backlog represented future revenue streams and added value to the Space & Defense Business. Lastly, petitioner argues that the timing of the sale increased the value of the Space & Defense Business because the Space & Defense Business was participating in the defense buildup of the Reagan administration.

In further reliance upon ***British Land***, petitioner maintains that the statutory formula is distorted because of differences in factors between domestic and out-of-state businesses. Similar to ***British Land***, petitioner contends that there is a distorting effect arising from the elimination of the Space & Defense Business from the "everywhere" denominator in the allocation factor. Petitioner then offers the following example:

> the denominator of the property factor for the short year ending August 17, 1989, as revised by the Conciliation Order dated September 13, 1996, was $119,588,213, but only $26,886,934 for the tax year ending June 30, 1990. (Division's Exhibit L, Schedule E1.) Similarly, wages decreased from $57,700,734 to $11,606,465. (Id.) These two factors

> contributed heavily to the nearly 500% increase in the business allocation percentage from short year ending August 17, 1989, of .9714% to the tax year ending June 30, 1990, of 4.7351% (Id.) This dramatic increase in the allocation percentage occurred even though Fairchild's receipts factor, which is appropriately double-weighted for New York business allocation purposes, decreased to 0% in the year of the sale of the Space and Defense Business, and wages decrease by nearly 12% ($1,135,482 to 998,416) in the same period. (Id.) Clearly, this had a distorting effect on the application of the statutory apportionment formula, which is another factor pointing to the clear and cogent evidence that the gain on the sale of the Space and Defense Business that the Division is attempting to tax is out of all appropriate proportion to the activities of Fairchild in the State of New York in the year of that sale. (Petitioner's brief, p. 26.)

The next point raised by petitioner is that the nature of the Fairchild Republic Business in New York changed upon its shutdown and any prior transfer of value is irrelevant to the later sale of the Space & Defense Business. It is petitioner's position that proof of a unitary relationship does not resolve the question of whether New York is attempting to tax extraterritorial value out of appropriate proportion to the taxpayer's activities within New York. According to petitioner, the facts establish that Matra SA. paid $245,000,000 plus interest for the Space & Defense Business because of business factors unrelated to Fairchild's New York activities.

Petitioner contends that Fairchild Republic's activities before its shutdown were not a factor in obtaining some portion of the gain from the sale of the Space & Defense Business. It is maintained that there is no evidence in the record to support the conclusion that Fairchild Republic's activities were one of the principal factors which were responsible for the gain on the sale of the Space & Defense Business. In addition, petitioner states that the record points to the negative impact of Fairchild Republic's activities on the value of the Space & Defense Business. In support of the latter point, petitioner notes that: the production of the Saab-Fairchild 340 incurred losses; Fairchild Republic and the Space & Defense Business produced distinct products; intercompany transfers were minimal; and that Fairchild paid a minimum tax of

$250.00 per year in years in which the business allocation percentage reported by Fairchild Industries was more than 25%. Lastly, petitioner states that none of the proceeds from the sale of the Space & Defense Business were used for any of the activities of the former Fairchild Republic which was Fairchild's only activity in New York.

D. Before addressing petitioner's arguments, a careful examination of ***British Land*** is in order. In ***British Land,*** the petitioner was a firm which was incorporated in Delaware in 1973. It was an indirect subsidiary of an international real estate investment company located in London. Petitioner's goal was to purchase property that would appreciate in value.

Following its incorporation, petitioner purchased for $4.8 million the capital stock of a Maryland corporation which owned a 27-story office building in Baltimore. In 1980, petitioner acquired a fee interest in the land of the Baltimore office building property. After the acquisition of the fee and the rental of the property, petitioner decided that the property should be sold. The sale took place in March 1984. Between the acquisition of the Baltimore property and the sale in 1984, petitioner incurred operational losses which required loans from other subsidiaries of petitioner's grandparent. In 1982, petitioner acquired an office building in New York City. Beginning in 1984, a vice-president of petitioner began occupying office space at the New York City building from which he managed petitioner's property as well as the property of other subsidiaries of petitioner's grandparent.

The Division of Taxation issued a notice of deficiency for the year 1984 asserting that corporation franchise taxes were due on 64 percent of the capital gain from the sale of the Baltimore property. The allocation to New York took into account the fact that the 1984 average value of the New York City property was about three times the value of the Baltimore property.

Therefore, the Division allocated more than $8.3 million of the $13 million gain from the sale of the Baltimore property to New York resulting in a tax due of $978,000.00.

The Tax Appeals Tribunal found in favor of the Division on the basis that petitioner was conducting a unitary business and that petitioner was unable to sustain its burden of demonstrating that the allocation formula resulted in the taxation of extraterritorial income. On review, the Appellate Division confirmed the decision of the Tribunal and dismissed the petition. The Court found that there was substantial evidence to support the determination that petitioner was a unitary business and that petitioner had not established that the statutory formula resulted in the taxation of extraterritorial income. In reaching this conclusion, the Court found that the comparison of the New York income shown by a separate geographic accounting to the apportionment result was insufficient as a matter of law to show the gross disproportionality of the apportionment.

On appeal, the Court of Appeals agreed with the conclusion of the Tax Appeals Tribunal that petitioner's New York City and Baltimore real estate activities were part of a unitary business which is a prerequisite to a constitutionally valid formula for the apportionment of income. The Court then addressed the more difficult question of:

> whether petitioner met its heavy burden of showing, by clear and cogent evidence, that application of the statutory formula attributes New York income to petitioner 'out of all appropriate proportion to the business transacted by [it] in that State' (citation omitted). Put another way, did petitioner establish that New York 'has applied a method [of apportionment], which, albeit fair on its face, operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction' (citation omitted)? ***Matter of British Land (Maryland), Inc. v. Tax Appeals Tribunal, supra,*** 623 NYS2d at 776.)

In examining the foregoing question the Court first concluded that the New York statutory formula was fair on its face. The Court also rejected the argument "that a tax on extraterritorial values can be established simply by showing that the taxpayer's formula-based interstate income is many times greater than the income reflected in a separate geographical accounting" (***Matter of British Land (Maryland), Inc. v. Tax Appeals Tribunal, supra,*** 623 NYS2d at 777).

The Court of Appeals disagreed with the Appellate Division in determining "that the only evidence submitted by petitioner that the application of the formula resulted in taxing extraterritorial values was the gross disproportionality of the gain on the Baltimore sale attributed to New York, $8.3 million, as compared to the net income of petitioner's New York operations shown in a separate geographical accounting." (***Id.***) First, the Court of Appeals pointed to four factors principally responsible for the appreciation in the value of the Baltimore property and determined that these factors, and any corporate decision-making pertaining to them, affected the Baltimore property before petitioner began its activities in New York. The Court concluded that as a result of the foregoing factors "and particularly because the single gain from the sale of the Baltimore property so dwarfed petitioner's other net income, clear and cogent evidence supports the conclusion that two thirds of petitioner's $13 million gain on the sale of the Baltimore property 'cannot in fairness be attributed to [petitioner's] activities in [New York] State' (citation omitted)." (***Id.***)

Before it concluded, the Court mentioned three additional factors which supported its decision. First, the Court noted that there was an absence of a significant countervailing flow of value to petitioner's Maryland operation from its activities or the decisions of its officers which were made outside of Maryland. Second, the Court noted that the Division decided to base the tax treatment of the sale of the Maryland property as part of a unitary business strictly limited to petitioner and its own individual property holdings rather than a larger unitary business which would include sister corporations and those corporations which were upstream. Therefore, the Court reasoned that contributions from the parent corporation or its subsidiaries could not be a basis for attributing additional New York income to the gain from the sale of the Baltimore property. Lastly, the Court noted that the New York property was a relatively recent acquisition at a far greater cost. During the year in issue its value was more than three times the value of the Maryland property. Under these circumstances, the large differences in value had a distorting effect on the apportionment formula. Accordingly, the Court concluded that the determination of the Tax Appeals Tribunal had to be annulled and the matter remanded to the Tribunal in order to redetermine the amount of petitioner's income that would fairly reflect petitioner's activities in New York.

E. The question presented is whether petitioner's case falls within the parameters of ***British Land***. First, petitioner states that there was a gross disproportionality between the gain and the taxpayer's net income from New York operations (petitioner has referred to this as the Gross Disproportionality Test).

The Division takes issue with petitioner's separate accounting calculation. It states:

> This breakdown of Fairchild's income and expenses between Fairchild Republic was not attached to the CT-3 for the fye 6/30/90 (Exh. Q) and thus has not been audited by the Division. Unfortunately, petitioner provided no testimony as to how the items of income and expenses were allocated to 'Republic' versus 'Corp Office'. Without this, the study is essentially meaningless, because, for all the record shows, some of the income allocated to 'Corp Office' could well have been attributable to the windup of Fairchild Republic's operations. Indeed, petitioner should have explained how it was that Fairchild Republic, despite having ceased operation, could still have had a cost of goods sold of $5,746,105. Without supporting testimony there is simply no way of verifying whether some of that cost of goods sold should have been booked in a prior year. Moreover, petitioner should have explained how it came about that Fairchild Republic had negative wages. Presumably, this means that some of [the] headquarter's wage expenses were allocated to Fairchild Republic. Without some discussion as to how that

> allocation was done, the wage expense is also unverifiable. Finally, petitioner should have provided detail of the $14 million in ‘other deductions’ shown for ‘Corp Office’, so that the Administrative Law Judge could determine if those deductions really belonged to the corporate office. (Division’s brief, p. 37-38.)

F. By the foregoing arguments, the Division is attempting to raise new factual arguments for the first time in a post hearing brief. At the time of the hearing, petitioner was not on notice of the alleged infirmities in the evidence. Since this practice of raising new factual arguments for the first time in a post hearing brief is impermissible, the arguments may not be considered (***Matter of Rubin Brothers Holding Co. & Others***, Tax Appeals Tribunal, May 18, 1995). In view of the fact that there were no gross receipts in New York and the Division has attributed nearly $10 million in gain to New York from the sale of the Space & Defense Business, it is concluded that petitioner has established that there was a gross disproportionality between the gain from the sale of the business and petitioner’s net income from New York operations.

G. The question remains whether the only evidence submitted by petitioner in support of the proposition that the application of the formula resulted in the taxation of extraterritorial values was the gross disproportionality of the gain on the sale of the Space & Defense Business compared with the loss from petitioner’s New York operations revealed by a separate geographic accounting (***Matter of British Land (Maryland), Inc. v. Tax Appeals Tribunal, supra,*** 623 NYS2d at 777).

In addition to the gross disproportionality, the taxpayer in ***British Land*** was able to show that there were four factors that were principally responsible for the appreciation in the value of the Baltimore property and that these factors had their economic impact before the taxpayer began its activities in New York. Moreover, the taxpayer was able to show that it made the decision to sell the Baltimore property before it began doing business in New York. Thus, in

British Land, the taxpayer made the decision to both acquire and dispose of the asset before it began operations in New York.

H. Petitioner's argument that the appreciation of the Space & Defense Business occurred after the closing of Fairchild Republic does not withstand scrutiny. The Division has correctly noted that gain on the disposal of the Space & Defense Business was the excess of the proceeds from the sale of the Space & Defense Business over the adjusted basis of the Business's assets less the cost of the sale (Division's brief, p.44). By arguing that the gain occurred after Fairchild Republic's shutdown, petitioner is, in effect, stating that as of December 1987, the Space & Defense Business had little or no value above the tax basis of its assets.

The record does not support the foregoing proposition. By December 31, 1987, the Space & Defense Business had been in operation for at least 17 years. For the calendar year ending December 31, 1987, the Space & Defense Business had sales of more than $122 million and operating income of more than $5 million. For the years ending December 31, 1986 and December 31, 1985, the Space & Defense Business's sales were $122,214,000.00 and $142,726,000.00, respectively, and operating income was $5,147,000.00 and $4,972,000.00, respectively. It is clear from the foregoing figures that when Fairchild Republic ceased operating, the Space & Defense Business was an active ongoing business whose value far exceeded the adjusted tax basis of its assets.

There is also merit in the Division's argument that, in explaining the causes of the appreciation of the Space & Defense Business, petitioner omitted certain factors which were attributable to the operation of the unitary business before the shutdown of the Space & Defense Business. First, it is clear from the record that the Fairchild name was considered valuable. As noted by the Division, after Banner purchased Fairchild Industries, Inc., Banner changed its name to "The Fairchild Corporation." Similarly, when Matra, S.A. acquired the Space & Defense Business, there was a clause in the contract giving Matra, S.A. the right to use the Fairchild name. At a later junction, Matra S.A. created the Fairchild Space & Defense Corp. to hold the Space & Defense Business assets. Other evidence that the Fairchild name had significant value is in the 1989 Carlyle study which suggests, as part of Carlyle's plan to acquire Fairchild, its intent to "capitalize on the company's historic strengths and the value of the Fairchild 'franchise'" (Acquisition of Fairchild Industries, Inc. by FII Transaction Partners, L.P., p. C000580). Lastly, petitioner allocated more than $68 million of the amount received from the sale, or more than 25% of the sales price, to "goodwill."

The Division's brief accurately notes that the value of the Fairchild name did not arise solely in the period starting with the shutdown of the Farmingdale facility and ending when the Space & Defense Business was sold. Petitioner's 1987 Annual Report notes that the Space & Defense Business had designed "fluid control hardware" for "[e]very major space and missile program from Gemini to the Minuteman through the Space Shuttle and MX . . ." (Fairchild Industries 1987 Annual Report, p.6). Similarly, the 1988 Carlyle study noted this accomplishment in describing the Space & Defense Business to potential investors.

The Division has also pointed to an additional factor which supports the conclusion that the appreciation in the Space & Defense Business's assets was attributable to Fairchild's unitary business prior to Fairchild Republic's shutdown. As noted in the 1989 Carlyle study, the Space & Defense Business had "skilled managers in place at the operating level" (Acquisition of Fairchild Industries, Inc. by FII Transaction Partners, L.P., p. C000574). This conclusion is buttressed by Matra, S.A.'s announced intention to retain the management of the Space & Defense Business due to good management.

In response to the foregoing, petitioner states that none of the reasons stated by the Division for the appreciation of the Space & Defense Business's assets is present in New York and therefore, they are irrelevant to support New York's taxation of that appreciation. Petitioner also contends that any goodwill developed by Fairchild Republic in the earlier years would have been destroyed by the losses it incurred prior to the shutdown. Petitioner also disputes that Fairchild Republic had anything to do with good management at the Space & Defense Business. Lastly, petitioner notes that the "very successful" unitary business paid only the minimum tax from 1978 through 1987.

Petitioner's argument fails to address an important feature of the ***British Land*** decision -- all of the critical decisions with respect to the purchase, management, and subsequent sale of the property occurred before the taxpayer's activities in New York began. It was for this reason that the taxpayer was able to show "that the gain on the sale of the Baltimore property was attributable in far larger part to 'factors . . . present in other States but not present in [New York]' (***Butler Bros. v. McColgan***, 315 U.S., at 509, . . .)." ***(Matter of British Land (Maryland), Inc. v. Tax Appeals Tribunal, supra,*** 623 NYS2d at 777.) Here there was an extended period of time when Fairchild Republic and the Space & Defense Business operated as a unitary business. It is this unitary relationship during an extended period of time in which both corporations were operating which permitted a countervailing flow of value and renders the application of the apportionment statute constitutional. The fact that Fairchild Republic only paid the minimum tax to New York for a period of time is not relevant to this issue.

The factors relied upon by petitioner to show that the appreciation of the Space & Defense Business was attributable to factors outside of New York are largely unpersuasive. Petitioner first points to Matra S.A.'s interest in the Space & Defense Business which was not present in New York. However, the Division has correctly noted that this argument is nothing more than a tautology. In purchasing the assets of only the Space & Defense Business, Matra S.A. was presumably not interested in Fairchild Republic. Nevertheless, this fact alone does not establish that the application of the apportionment formula resulted in the taxation of extraterritorial values. In ***British Land*** the Court did not conclude its analysis with the finding that the real property was located in Maryland. Rather, the Court proceeded to explore whether the application of the statutory formula attributed to New York income "to petitioner 'out of all appropriate proportion to the business transacted by [it] in that State' (citation omitted)." ***(Matter of British Land (Maryland), Inc. v. Tax Appeals Tribunal, supra,*** 623 NYS2d at 776.) The attempt in petitioner's reply brief to show the relevancy of ***British Land*** merely restates the uncontested fact that the Space & Defense Business was neither headquartered in New York nor maintained manufacturing or operating facilities in New York.

The Division has also correctly noted that petitioner's second and fourth factors, the increases in sales and operating income and the increase in a backlog, were attributable to the period of time that Fairchild Republic and the Space & Defense Business were operating as a unitary business. It is unreasonable to think that the increasing sales would arise overnight and the evidence does not support this conclusion. For example, the 1987 Annual Report states that a major reason for the success of the Fairchild Communications & Electronics Company, which was part of the Space & Defense Business, was the Data Transfer System which was developed for the U.S. Air Force F-16 airplane in 1981. Similarly, the Topex and Explorer Platform contracts were mentioned in the 1986 Annual Report with the comment that Fairchild Space company was selected to negotiate the contracts in that year.

In response to the foregoing examples petitioner argues that:

> [o]nce again, the Division argument only discusses whether there was appreciation, not whether any appreciation is attributable to New York. The 1981 Fairchild Annual Report (Division Exhibit S) indicates that this data transfer system contract was awarded to the Space and Defense Business [sic] . . . There is no indication that Fairchild Republic was in any way involved in that contract. Neither is there any support for attribution to Fairchild Republic of the Explorer Platform and NASA Ocean Topography Experiment contracts awarded in 1987. (Petitioner's reply brief, p. 24.)

The foregoing argument is also infirm. Since Fairchild Republic and the Space & Defense Business operated as a unitary business during which time significant corporate decision-making occurred, there was a countervailing flow of value which precludes a determination that there was an unconstitutional application of the apportionment statute.

The third factor raised by petitioner is similarly rejected. It is petitioner's position that Matra, S.A. was looking for a business that would provide it with access to the United States market. A difficulty with this argument is that it is impossible to distinguish it from some of the other points raised by petitioner. That is, it is unlikely that the Space & Defense Business would have been chosen by Matra S.A. as a vehicle for entry into the United States market if it did not have an increase in gross sales and operating income or if it did not appear that the Space & Defense Business had a bright future. In view of the unitary nature of Fairchild Industries, petitioner may not characterize the third factor as attributable to factors which are solely outside the State of New York.

Lastly, it is petitioner's position that there was a gain because the sale occurred during the time of the defense buildup of the Reagan administration. In response, the Division contends that, at the time of the sale, the defense buildup had ended and cites for support Federal budget figures obtained from the Statistical Abstract of the United States and a newspaper article from the Washington Post newspaper dated August 29, 1989 which mentioned that defense spending was slowing down.

The last factor raised by petitioner supports petitioner's position. The Space & Defense Business was sold pursuant to an asset purchase agreement dated May 31, 1989. The actual transfer occurred on August 25, 1989. According to the figures relied upon by each of the parties, the Federal budget outlay for National defense was $290,361 million for 1988, $303,559 million for 1989 and $299,331 million for 1990. The foregoing figures show that at the time of the sale, expenditures for national defense were rising. The reduction in defense spending occurred after the sale and presumably did not affect the sales price. Moreover, the newspaper article relied upon by the Division was published after the sale and therefore, could not have affected the thinking of the parties to the transaction.

The next question is whether the one factor above supports the finding that the application of the statutory formula "attributes New York income to petitioner 'out of all appropriate proportion to the business transacted by [it] in that State' (citation omitted)." ***(Matter of British Land (Maryland), Inc. v. Tax Appeals Tribunal, supra,*** 623 NYS2d at 776.) It is concluded that since Fairchild Republic and the Space & Defense Business operated together as a unitary business for many years and that the only factor petitioner has been able to point to in order to establish a tax on extraterritorial values is the timing of the sale, petitioner has not established that the gain on the sale of the Space & Defense Business was "was attributable in far larger part to 'factors . . . present in other States but not present in [New York]' (***Butler Bros. v. McColgan***, 315 U.S., at 509, . . .)." ***(Matter of British Land (Maryland), Inc. v. Tax Appeals Tribunal, supra,*** 623 NYS2d at 777.)

I. It is petitioner's contention that the statutory apportionment formula was distorted by the change in the property and wage factors occasioned by the sale of the Space & Defense Business. This argument misconstrues the concept of distortion. Obviously, anytime there is a sale of an out-of-state business and the closing of a domestic enterprise, there will be a change in the allocation formula because of the way the allocation is computed. This is a different situation from the distortion in ***British Land*** which was caused by the relatively recent acquisition of land in New York at a far greater cost than the land held outside of New York.

J. Petitioner's contention that the historic activities of Fairchild Republic do not preclude a finding that the Division impermissibly taxed the gain from the sale of the Space & Defense Business has been addressed in the context of other arguments and will not be considered further.

K. Petitioner argues that the Division abused its discretion by failing to adjust Fairchild's entire net income for the year ended December 31, 1988 by the amount of the abandonment loss allegedly incurred by Fairchild and by refusing to modify the property factor to reflect the elimination of the abandoned assets in 1988. It is noted that while petitioner included the abandonment loss in its Federal income tax return for the year ended June 30, 1992, on the basis of the announced shutdown of the Fairchild Republic Division in 1987, some of the buildings located at that facility were abandoned in 1988 and, according to petitioner, it would be entitled to deduct the basis in those buildings pursuant to the provisions of the Internal Revenue Code and Treasury Regulations.

The Division maintains that petitioner is not entitled to a deduction for an abandonment loss in 1988, with respect to the buildings located at the Fairchild Republic facility, because it has not established the elements of the loss. The Division also contends that the abandonment loss should be denied because the Division did not have the opportunity to consider the deduction during the audit.

L. When depreciable property is permanently retired from use in a trade or business or in the production of income, the regulations of the Commissioner of Internal Revenue, under IRC § 167, provide for the recognition of a loss under certain conditions. The Regulations provide, in part, as follows:

> In order to qualify for the recognition of loss from physical abandonment, the intent of the taxpayer must be irrevocably to discard the asset so that it will neither be used again by him nor retrieved by him for sale, exchange, or other disposition. (Treas Reg § 1.167[a]-[8][a][4].)

It has been recognized that in order for there to be an abandonment, there must be an intent to abandon and a decisive and conclusive act to indicate intent (***Middleton v. Commr***., 77 TC 310, ***affd*** 693 F2d 124). A deduction for an abandonment loss is only available in the taxable year in which the loss is sustained (Rev Rul 54-581).

M. The Division has accurately noted that the weight of the evidence does not support the conclusion that petitioner intended to abandon the buildings in issue in 1988. In October 1988, petitioner entered into a contract with Retail Stores Credit Corp. to sell 88 of the approximately 100 acres that comprised Fairchild Republic's real property in Farmingdale, New York. The contract remained in effect until November 1989 when Retail Stores Credit Corp. terminated its contract to purchase the property because of Fairchild's inability to obtain the necessary environmental clearance. Contrary to petitioner assertions, the contract shows that the proposed purchaser was interested in the buildings located on the real estate. Section 21(B) of the contract acknowledged that the seller would remove some tanks and equipment and that the seller intended to sell various fixtures, equipment, and personal property. Pursuant to this paragraph, the seller was under no obligation to fill holes or otherwise restore or repair the premises except, however, the seller agreed to restore any damage to five particular buildings as a result of its closure plan. Section 4(C) of the contract also provided that, subject to a monetary limit, the seller was expected to cure any violations of law that affect the same buildings as in paragraph 21(B). It is also instructive that petitioner was required to maintain insurance on the same designated buildings. Clearly, the insertion of the foregoing provisions establish that the proposed purchaser was interested in utilizing certain buildings.

The fact that petitioner chose to claim an abandonment loss on its Federal income tax return for the year 1992 also supports the inference that it did not intend to abandon the property in 1988. It is reasonable to expect that if petitioner had intended to abandon the property in 1988, it would have claimed the abandonment loss in that year.

N. Petitioner's opposing arguments have been considered and rejected. The fact that Fairchild announced the closure of Fairchild Republic on March 13, 1987 does not establish that Fairchild intended to abandon the property at that time within the meaning of Tax Law § 167 because it does not show that the buildings would not be used or retrieved for sale, exchange, or other disposition (Treas Reg § 1.167[a]-[8][a][4]). Similarly, the fact that Fairchild stopped depreciation on the Fairchild facility on December 31, 1987 for financial reporting purposes does not show an intent to abandon the facility. Since the buildings, machinery and equipment were not being used in production, a proper matching of income and expenses warrants the decision to stop depreciation for financial reporting purposes.

In view of the foregoing, arguments by the Division regarding when the buildings were razed, whether real estate taxes were paid, and whether the Division had a meaningful opportunity to review petitioner's abandonment loss claim are rendered moot and will not be considered.

O. Another point raised in petitioner's brief is that it was error to use its book value in determining the property factor. Petitioner submits that the New York franchise tax returns which it filed for the years in issue inadvertently used book value in determining the property factor for franchise tax purposes. It is contended that during the audit the Division was provided workpapers which set forth the adjusted Federal tax basis in determining the property factor. In response, the Division declined to use these workpapers to modify the property factor to reflect the adjusted Federal tax basis. Petitioner maintains that the one-time election to use fair market value rather than the adjusted basis for Federal tax purposes was not made on Fairchild's 1987 return and does not provide a reason for using book basis rather than the adjusted tax basis for Federal income tax purposes. Petitioner posits that it did not elect to use fair market value on its General Business Corporation Franchise Tax Report for the year ending December 31, 1987 because it placed an "X" in the no box next to the question "Are you making an election to use fair market value in your property factor?". It is submitted that the Division's use of book value to determine petitioner's property factor is impermissible because the answer petitioner gave on the return for 1987 determines whether it made the revocable election to use fair market value.

Petitioner also contends that the Division's desire for consistency ignores Tax Law § 210(3)(a)(1) and the regulations promulgated pursuant to this section. Lastly, petitioner argues that it is improper for the Division to use statements contained in subsequent returns to show that it intended to use book value because: (1) the statute does not provide an option to use book value; (2) the answers to questions regarding the use of fair market value on returns subsequent to 1987 are irrelevant to whether petitioner made an election in 1987; (3) the answers by Fairchild on subsequent returns regarding the use of fair market value are irrelevant because the election had to be made by the due date of the 1987 return; and (4) any responses to questions regarding the use of fair market value in the property factor in returns filed for tax years after 1987 which were inconsistent with the 1987 return were errors on the subsequent returns and should be ignored.

The Division argues that petitioner is not entitled to use its adjusted tax basis in determining the property factor under Tax Law § 210(3)(a)(1). It is the Division's position that when all of the evidence of petitioner's intent is considered, it is clear that petitioner intended to use fair market value on its return for its 1987 tax year. It is further argued that the following three years' annual returns establish that petitioner intended to use the alternative valuation factor for the property factor. Moreover, according to the Division, even if petitioner established that it was entitled to use the adjusted basis valuation, petitioner has not shown what the property factor figures should be.

P. Prior to the amendment of the Tax Law in 1987, a taxpayer was required by Tax Law former § 210(3)(a)(1) to use the fair market value of its property within and without New York in determining the property factor of the business allocation percentage. Section 27 of chapter 817 of the laws of 1987 amended section 210(3)(a)(1) of the Tax Law by adding a provision which states, in part, that:

> the term 'value of the taxpayer's real and tangible personal property' shall mean the adjusted basis of such properties for federal income tax purposes; provided, however, that the taxpayer may make a one-time, revocable election, pursuant to regulations promulgated by the tax commission to use fair market value as the value of all of its real and tangible personal property, provided that such election is made on or before the due date for filing a report under section two hundred eleven for the taxpayer's first taxable year commencing on or after January first, nineteen hundred eighty-seven and provided that such election shall not apply to any taxable year with respect to which the taxpayer is included on a combined report unless each of the taxpayers included on such report has made such an election which remains effect for such year.

Q. The record shows that despite its response on the return, the figures used by petitioner to calculate the property factor on the return for the year ending December 31, 1987 were based on net book value as a measure of fair market value. On the General Business Corporation Franchise Tax Return for the year ending December 31, 1988, petitioner placed an "X" in the yes box in response to the question "Did you make an election last year to use fair market value in the property factor?". On it return for the period ending August 17, 1989, an "X" was placed in the yes box in response to the question "Did you make an election last year to use fair market value in the property factor?" Similarly, petitioner answered yes to the question "Did you make an election to use fair market value in your property factor?" on its General Business Corporation Franchise Tax Return for the period ended June 30, 1990. In each of the returns, the figures used by petitioner to calculate the property allocation percentage were based on net book value as a measure of fair market value rather than Federal adjusted tax basis.

R. It is clear from the foregoing facts that petitioner intended to use book value as a measure of fair market value to calculate the property factor on the 1987 return and that the "X" was unintentionally placed in the wrong box. There is no support for the proposition advanced by petitioner that the Division is confined to looking at where the X is placed in a particular box and may not review the return as a whole. In view of the amount of effort involved in completing the property allocation portion of the return as opposed to placing an X in a box, it is obvious that the error was in placing an X in the wrong box and that the intent was to use fair market value to calculate the property factor.[4]

The intent to utilize fair market value in 1987 is demonstrated by the return filed for the year 1988. On the return for 1988, petitioner stated that it had elected in the prior year to use fair market value in its property factor. The statement on the tax return is a better indicator of petitioner's intent in 1987 than the testimony of petitioner's witness because it is closer in time to the preparation of the return for 1987. It is also noted that the statement on the 1987 return was not made under the pressures of litigation. Perhaps the most convincing indicator of petitioner's intent is the fact that petitioner chose to use net book value as a measure of fair market value in 1987 and in each succeeding year. It is reasonable to expect that petitioner would not have consistently used net book value if it intended to use Federal adjusted tax basis. Therefore, petitioner's claim that the responses on the returns for the years after 1987 were in error and should be disregarded is rejected.

It is recognized that the Division had a practice of accepting the use of net book value as an approximation of fair market value. Having taken advantage of this policy for a period of years, petitioner may not complain that the policy is unacceptable or that it was mistaken in following this practice.

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[4] Under the circumstances, the testimony of petitioner's vice president of taxes that he believed that fair market value was not elected is not convincing.

S. The last issue presented is whether there is reasonable cause for the abatement of the penalty imposed pursuant to Tax Law § 1085(k). This section provides, in pertinent part, as follows:

> Substantial understatement of liability.-- If there is a substantial understatement of tax for any taxable year, there shall be added to the tax an amount equal to ten percent of the amount of any underpayment attributable to such understatement . . . . The amount of such understatement shall be reduced by that portion of the understatement which is attributable to the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment, or any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return. The tax commission may wave all or any part of the addition to tax provided by this section on a showing by the taxpayer that there was reasonable cause for the understatement (or part thereof) and that the taxpayer acted in good faith.

T. In its brief, petitioner claims that the substantial understatement penalty for the tax year ended June 30, 1990, is related to the gain from the sale of the Space & Defense Business. Petitioner also maintains that its exclusion of the gain from the sale of the Space & Defense Business should not be subject to the substantial understatement penalty because it had substantial authority for its position, its position was adequately described on its return, and it had reasonable cause for its position.

In response to the foregoing, the Division asserts that petitioner has not shown that it relied on substantial authority in understating its tax liability. The Division also maintains that petitioner has not shown that it acted with reasonable cause or that the relevant facts were adequately disclosed on the return.

In its reply brief, petitioner reiterates its position that there was substantial authority for its position. Petitioner also posits that the disclosure on its return with regard to the sale of the Space & Defense Business was sufficient to meet the requirements of 20 NYCRR 536.2(c)(3).

Finally, petitioner contends that its arguments with regard to the ***British Land*** case provide adequate evidence that its position was an honest and reasonable misunderstanding of the law.

U. Tax Law § 1085(k) provides that the amount of the understatement is to be reduced by the portion of the understatement which is attributable to the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment. The term "substantial authority" is not defined in the statute or regulations pertaining to corporation franchise tax. However, Tax Law § 1085(k) is substantially the same as IRC former § 1661 (now IRC § 1662). Therefore, it is appropriate to refer to the corresponding Federal regulations and case law (***see, Matter of Levin v. Gallman*,** 42 NY 32, 396 NYS 623). The Treasury Regulations define "substantial authority," in pertinent part, in Treasury Regulation § 1.6662-4(d) as follows:

> (2) *Substantial authority standard*. The substantial authority standard is an objective standard involving an analysis of the law and application of the law to relevant facts. The substantial authority standard is less stringent than the 'more likely than not' standard (the standard that is met when there is a greater than 50-percent likelihood of the position being upheld), but more stringent than the reasonable basis standard (the standard, which if satisfied, generally will prevent imposition of the penalty under section 6662(b)(1) for negligence). A return position that is arguable, but fairly unlikely to prevail in court, satisfies the reasonable basis standard, but not the substantial authority standard. The possibility that a return will not be audited or, if audited, that an item will not be raised on audit, is not relevant in determining whether the substantial authority standard (or the reasonable basis standard) is satisfied.
>
> (3) *Determination of whether substantial authority is present --(i) Evaluation of authorities*. There is substantial authority for the tax treatment of an item only if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment. All authorities relevant to the tax treatment of an item, including the authorities contrary to the treatment, are taken into account in determining whether substantial authority exists. The weight of authorities is determined in light of pertinent facts and circumstances in the manner prescribed by paragraph (d)(3)(ii) of this section. There may be substantial authority for more than one position with respect to the same item. Because the substantial authority standard is an objective standard, the taxpayer's belief that there is substantial authority for the

> tax treatment for an item is not relevant in determining whether there is substantial authority for that treatment.
>
> (ii) *Nature of analysis*. The weight accorded an authority depends on its relevance and persuasiveness and the type of document providing the authority. For example, a case or revenue ruling having some facts in common with the tax treatment at issue is not particularly relevant if the authority is materially distinguishable on its facts, or is inapplicable to the tax treatment at issue. . . .
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> (4)(iv)(C) *When substantial authority is determined*. There is substantial authority for the tax treatment of an item if there is substantial authority at the time the return containing the item is filed or there was substantial authority on the last day of the taxable year to which the return relates.

Evaluated by the foregoing standard, petitioner has not established that it had substantial authority for excluding the gain from the sale of the Space & Defense Business for the tax year ended June 30, 1990. Petitioner's reliance upon ***British Land*** is misplaced because the Court of Appeals rendered its determination in that matter on February 16, 1995 which is well after the time that the return for the fiscal year ended June 30, 1990 was due (Treas Reg § 1.6662-4[d][3][iv][C]).

Petitioner's reliance upon ***People ex rel. Sheraton Bldgs. v. Tax Commn***. (15 AD2d 142, 222 NYS2d 192, ***affd*** 13 NY2d 802, 242 NYS2d 226) and ***Matter of Bonner Properties*** (State Tax Commn., April 6, 1984) for the proposition that there is substantial authority for excluding the gain from the sale of the Space and Defense Business is also misplaced. In each of the foregoing cases, the business conducted in New York and the business operated outside of New York, which was sold, were totally unrelated. This is in sharp contrast to the present case where it is stipulated that the business in New York and the business outside of New York, which was sold, were unitary (***see, Matter of Christian Salvensen***, Tax Appeals Tribunal, April 2, 1998).

The question of whether there was adequate disclosure of petitioner's treatment of the sale of the Space & Defense Business on the tax return is presented next. Here, line 16 on page one of the franchise tax return for the period ended June 30, 1990 reports a subtraction modification of $209,335,730.00. The seventh page of the franchise tax return consists of an attachment which states, in pertinent part:

> THE SUBTRACTION FROM INCOME LISTED ON LINE 16 IS FOR THE GAIN FROM THE SALE OF NON-UNITARY ASSETS PERSUANT [sic] OF [sic] THE FINDING IN BONNER PROPERTIES, INC. VS. NEW YORK STATE, MAY 15, 1984.

Under prevailing Federal precedent, disclosure is considered adequate if there is sufficient information to enable the Division to identify the potential controversy involved (***see, Schirmer v. Commr***., 89 TC 277). Here, the reporting of an amount as a subtraction modification on the first page of the return does not, in and of itself, enable the Division to identify the controversy at issue (***see, Schirmer v. Commr***., ***supra***). Moreover, the statement set forth on the seventh page of the return states only one fact, that the gain is from the sale of non-unitary assets, which is erroneous. Obviously, such disclosure is inadequate to identify the controversy.

V. The question remains whether petitioner has established reasonable cause for the waiver of the penalty. Relying upon 20 NYCRR 46.1(f)(2) petitioner asserts that "[i]f it is determined that it misunderstood or misapplied the law, then it should be determined that it did so honestly based on a reasonable interpretation of the law to the facts presented herein." (Petitioner's brief, p. 44.)

In response to the foregoing, the Division argues that good faith is absent because there is no showing of the relevant facts in petitioner's return for the fiscal year ended June 30, 1990 and because the authorities cited by petitioner are inapposite.

In its reply brief, petitioner contends that the ***British Land*** case demonstrates that its position was an honest and reasonable misunderstanding of the law.

W. In addition to the reasonable cause standard, the Division's regulations concerning waiver of penalty for substantial underreporting provide for a waiver upon a showing of good faith by the taxpayer. Specifically, the regulations provide, in pertinent part, that:

> (2) In determining whether reasonable cause and good faith exist, the most important factor to be considered is the extent of the taxpayer's efforts to ascertain the proper tax liability. In addition to any relevant grounds for reasonable cause as exemplified in subdivision (d) of this section, circumstances that indicate reasonable cause and good faith with respect to the substantial understatement of tax, where clearly established by or on behalf of the taxpayer, may include the following:
>
> (i) an honest misunderstanding of fact or law that is reasonable in light of the experience, knowledge and education of the taxpayer;
> (ii) a computational or transcriptional error;
> (iii) the reliance by the taxpayer on any written information, professional advice or other facts, provided such reliance was reasonable and the taxpayer had no knowledge of circumstances which should have put the taxpayer on inquiry as to whether such facts were erroneous (20 NYCRR 46.1[f][2]).

X. Under the facts of this case, petitioner has not shown that it acted in good faith as described in the Division's regulations. First, Fairchild Republic and the Space & Defense Business operated as a unitary business over a period of many years. To then say, after a relatively brief period of inactivity on the part of Fairchild Republic, that none of the gain was attributable to Fairchild Republic appears, on its face, to be an extreme reporting position. Second, the information petitioner offered on its tax return for the fiscal year ended June 30, 1990 was both unnecessarily brief and erroneous. The inference to be drawn is that petitioner intentionally chose not to be forthcoming.

Y. The petition of Fairchild Holding Corp., as assumer of, and Shared Technologies Fairchild, Inc., as successor to Fairchild Industries, Inc. is denied, and the Notice of Deficiency issued on October 31, 1994, as modified by the conciliation order, is sustained.

DATED: Troy, New York
September 24, 1998

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE